

# Monetary policy decision-making and communication under high uncertainty in Mexico: lessons from two episodes

Banco de México

## 1. Introduction

In recent years, heightened uncertainty has been one of the most significant challenges for central banks' policymaking. It has encouraged institutions to strengthen their analytical frameworks and to enhance their strategies for communicating with the public. Monetary policy decisions under conditions of high uncertainty require rigorous internal analysis, careful deliberation, broad policy discussions and a collective learning process for well-grounded assessments. Effective communication with the public builds on this foundation but needs to translate the complex analysis into clear messages that convey the institution's understanding.

Uncertainty is, by its very nature, hard to measure, making evidence-based policy analysis more difficult. Researchers have developed insightful methods for measuring uncertainty, such as text-based indices or statistical models that seek to extract information from observable variables. Nevertheless, its true magnitude remains elusive. This constraint on our knowledge makes it all the more important to confront uncertainty openly, recognising its presence in different forms and the limitations it imposes on economic analysis.

To address the challenges posed by uncertainty, a first step is to try to identify its sources. Next, there is the difficulty of attempting to quantify uncertainty, as well as to understand how it may affect the behaviour of economic agents, which ultimately determine macroeconomic outcomes. In relation to the latter point, policymakers face the issue of model limitations given that, in certain situations, existing models may provide a poor guide for the evolution of the economy. Lastly, the possibility of structural change would further imply that models and statistical tools may offer little guidance for what can be expected. These issues are not independent of one another and often reinforce each other.

Effective and robust monetary policy requires analytical frameworks that are adaptable to varying contexts in order to provide well-founded analysis for a host of sources of uncertainty that may be at play at any given moment. It also requires that communication strategies adjust and innovate, if necessary, in order to maintain transparency, enable a clear communication of monetary policy decisions and keep inflation expectations well anchored. To illustrate these challenges from the point of view of the Mexican experience, this article covers two recent episodes of heightened uncertainty: the Covid-19 pandemic and its aftermath and the recent shift in US trade policy.

## 2. Episode 1: the Covid-19 pandemic and its aftermath (2020–24)

In early 2020, the Covid-19 pandemic caused three large simultaneous shocks that posed an unprecedented test for central banks worldwide. For Mexico, as elsewhere, these shocks not only brought activity to a sudden halt but also created disruptions that shaped the economic recovery and the evolution of inflation in subsequent years. Production restrictions fractured supply chains and generated widespread input shortages, creating a supply shock. Social distancing measures – including mobility restrictions, school and workplace closures, and the suspension of many services – caused a demand shock, with spending collapsing, savings increasing and consumption shifting towards goods that were less affected by the pandemic, and away from services. At the same time, heightened uncertainty and risk aversion triggered a financial shock that led to equity prices falling sharply, emerging market currencies depreciating, term premia rising and sovereign spreads widening.

The global recovery began in the second half of 2020, supported by unprecedented fiscal and monetary support, the lifting of restrictions and the rollout of vaccination campaigns. Expansive fiscal programmes, particularly in advanced economies, sustained incomes and jobs, while accommodative monetary policies and financial market measures preserved confidence. Together with pent-up demand, these actions spurred a rebound in output, though this was uneven across countries. Inflation rose alongside the recovery and by mid-2021 some emerging market central banks, including Banco de México, began tightening policy. In 2022, lingering supply bottlenecks, rising commodity prices and the war in Ukraine drove inflation to multi-decade highs in many jurisdictions, prompting a broad wave of monetary tightening. By 2023–24, global growth had slowed and disinflation was under way.

Mexico's economic trajectory reflected not only these global forces but also distinctive domestic choices. Financial authorities introduced temporary relief measures addressed to debtors, stakeholders and savers. Banco de México adopted a timely and prudent approach. At the onset of the crisis, the central bank launched a comprehensive package of liquidity and market stabilisation measures to restore orderly market functioning. The extraordinary measures ended in the fourth quarter of 2021, as market conditions improved. Regarding monetary policy, the central bank lowered the reference rate from 7% in March 2020 to 4% in February 2021.

As price pressures emerged in 2021, the central bank raised interest rates at every meeting between June and November. Later on, the complexity of the outlook demanded increasingly forceful action. In December 2021, the pace of tightening doubled to 50 basis points per meeting. As inflation continued to rise, the Governing Board took the unprecedented step of raising the policy rate by 75 basis points in June 2022, delivering four consecutive hikes of this magnitude. Smaller increases followed until the end of the hiking cycle in March 2023. In total, the policy rate rose from 4% in mid-2021 to 11.25%, where it remained for a year. During this period, the disinflation process advanced significantly. In March 2024, with the inflation outlook much improved, the Governing Board began to ease monetary conditions. Overall, the policy rate was lowered by 125 basis points during 2024, closing the year at 10%.

Throughout this episode, pervasive uncertainty shaped both the analysis and the decisions of monetary authorities. The unprecedented nature of the shocks challenged existing models, complicated inflation forecasting and introduced the

possibility of large structural changes. Banco de México adapted its responses to the specific challenges at hand. This flexibility was essential to promote stability and confidence during the economic downturn, as well as to keep inflation expectations anchored and preserve credibility when price pressures started to mount.

Quantifying uncertainty and gauging agents' responses proved complex. At first, the magnitude, duration and costs of the pandemic – economic and human – were unknown. Responses by economic agents could not have been fully anticipated at the beginning of the health crisis. For example, while a drop in demand for services by consumers could have been expected, the observed surge in demand for goods came as a surprise. The timing and scale of measures varied widely across countries, shaped by institutional frameworks, cyclical positions and available resources. Whereas in emerging market economies fiscal support was relatively contained, the large fiscal stimulus in advanced economies boosted global demand. For example, Mexican exports and remittances into the economy expanded in 2020–21, outcomes not expected at the onset of the crisis.

During this episode, model and parameter uncertainty was especially acute. The abrupt shift in consumption patterns, the collapse of services activity and widespread supply disruptions raised doubts about whether traditional models of monetary transmission still applied. As in other central banks, policymakers questioned whether interest rate adjustments would influence demand as before, how persistent the shocks to output and consumption might be, and what the implications were for inflation and its expectations. To navigate this environment, Banco de México adopted a data-dependent approach. It also implemented scenario-based analysis to illustrate the potential magnitude and persistence of the economic downturn. These scenarios, published in Banco de México's Quarterly Reports for the first half of 2020, made risks explicit. Once more information about the magnitude of the initial adverse effects became available, the central bank resumed publishing a single central scenario, while continuing to stress the highly complex and uncertain environment. In addition, to cope with various unknowns during this period, the central bank turned to new sources of information in order to track the economy in real time. Alongside traditional statistics, it leveraged new unconventional indicators – Google mobility and social containment indices, contagion and fatality rates, weekly banknote allocations to meet soaring cash demand, and measures of shipping activity – to complement policy analysis and monitor the drivers of production, consumption, savings and prices.

By 2021–22, the main source of uncertainty had shifted from doubts regarding the likely evolution of economic activity to the nature and duration of emerging inflationary pressures. Inflation more than doubled, from 3.5% in January 2021 to 8.7% in August 2022 – the highest rate in two decades. While the upward trend was evident by mid-2021, the timing and magnitude of future price pressures remained unclear.

In this context, the central bank deepened its analytical work to reinforce its communication toolkit. Technical boxes in its Quarterly Reports explained how external shocks were influencing domestic inflation and detailed the evolving contours of its monetary policy strategy. These boxes examined how external shocks fed into domestic inflation – through global food commodity prices, the nature of price revisions during the pandemic and the asymmetric effects of global shocks on merchandise versus services prices.

Banco de México's policy actions and communication during the pandemic reflected the multifaceted nature of the uncertainty that prevailed during this period. Throughout the episode, the central bank adjusted its communications to better convey its assessment of the economy and its expected path for inflation, and to provide markets with a clearer signal of the central bank's reaction function. All of these changes were made under the recognition that communication with the public is a key instrument in conducting monetary policy and constitutes an effective mechanism for transparency and accountability.

In addition, Banco de México recognised that monetary authorities themselves, through their messages, play a relevant role in expectation formation, particularly in anchoring medium- and long-term inflation expectations. By mid-2021, given the atypical nature of the pandemic shocks, the inflation outlook was changing significantly from one monetary policy meeting to the next. At that time, inflation forecasts were published only four times a year – too infrequently to capture the rapid evolution of price pressures. To address this, the central bank decided to publish forecasts more frequently, providing more timely information on its assessment of inflation dynamics. Accordingly, in August 2021 the Governing Board announced that, from that moment onwards, monetary policy communiqués would include updated projections of headline and core inflation for the next eight quarters. In addition, the communiqués would disclose the vote of each Board member. This timely information gave the public a clearer understanding of the Governing Board's decision-making process and of the central bank's reaction function, thereby helping to mitigate monetary policy uncertainty.

Starting in December 2021, Banco de México began publishing, alongside its annual inflation forecasts, projections for the seasonally adjusted quarterly variations of both headline and core price indices. Unlike annual variations, these measures exclude base effects and therefore provide a clearer picture of the central bank's assessment of the likely persistence of specific price shocks. Distinguishing between temporary and persistent shocks is essential for guiding agents' inflation expectations. This measure was thus intended to address uncertainty about perceived inflation persistence and its effects on the formation of inflation expectations.

From May 2022 onwards, the Governing Board began to include forward guidance on future rate decisions in its policy communiqués. This provided analysts and markets with additional information about Banco de México's assessment of the inflation outlook and, in turn, about its intentions for monetary policy. Importantly, this guidance did not imply a commitment to specific actions. Rather, it served as an indication of the likely path of policy given the information available at the time of each meeting.

Taken together, these measures strengthened Banco de México's transparency and communication policy and supported the effective conduct of monetary policy to contain inflation.

### 3. Episode 2: shift in US trade policy

The second episode of heightened uncertainty began unfolding even as the effects of the pandemic had not fully faded out. In January 2025, the incoming US administration undertook the America First Trade Policy, which signalled a sharp shift

away from its long-standing open trade stance. In February and March 2025, US executive orders announced significant additional tariffs for Mexico, Canada and China, its major trading partners. Tariffs soon became more widespread as a global minimum of 10% was established in April 2025, with several countries facing higher baseline rates. In addition, at the time of writing several sectoral tariff measures involving autos, auto parts, certain metals and their derivatives, lumber and pharmaceuticals have been implemented. The trade relationship between the United States and China has been particularly tense, with several rounds of tit-for-tat tariff and non-tariff measures. Throughout, announced measures were often paused or modified, adding to the overall uncertainty that persisted during this episode.

The shift in US trade policy was particularly concerning for Mexico, given the deep economic integration between the two countries developed over three decades under the North American Free Trade Agreement (NAFTA) and the United States-Mexico-Canada Agreement (USMCA). After negotiated exemptions and pauses to the entry into force of certain announcements, a large number of products exported by Mexico to the United States became subject to an additional tariff of 25% as of March 2025 if not covered by the USMCA, while those that comply with the trade treaty have been exempted from additional tariffs, unless they face their own sectoral tariff measures. While in late October 2025 the final tariff treatment that Mexico will face is still being negotiated, tariffs are expected to be lower than those originally announced in March 2025. Indeed, estimates under current measures imply an average effective tariff rate of 13% under the 2024 structure of Mexican exports to the United States. Nonetheless, in July 2025 the effective tariff rate was 5.5%, partly as a reflection of a significantly increased use of the USMCA by exporters.

The initial tariff announcements, which were heavily directed towards Mexico, suggested that the main risk the country faced was the direct impact of additional trade barriers on its external demand. However, as tariffs were gradually extended to other countries – particularly China – Mexico's relative tariff treatment improved. The main risk shifted from the direct effects that tariffs could have on Mexican exports, to the indirect impact stemming from the effect that the shift in US trade policy could have on its own economy. As tariffs became broad-based, expectations started to shift, considering an economic slowdown in the United States was more likely than before.

In this context, by mid-2025 the Mexican economy performed better than the external environment would have suggested. While investment spending was negatively affected by the overall level of uncertainty, exports kept growing, defying initial expectations. As mentioned, Mexican exporters adjusted towards a greater use of the USMCA. By July 2025 the share of USMCA-compliant exports had risen from under 50% to over 80%. At the same time, some firms front-loaded shipments ahead of tariff deadlines, while others fulfilled contracts despite higher costs, expecting measures to be temporary. Meanwhile, in tandem with a generalised US dollar depreciation, the Mexican peso unexpectedly appreciated. Indeed, despite initial expectations of a sharp depreciation and episodes of volatility around the dates of tariff announcements, the Mexican peso has tended to appreciate, recording an appreciation of over 10% against the US dollar between January and mid-October 2025.

While the pandemic was dominated by hard-to-quantify shocks that challenged existing models, the US trade policy shift episode has been hard to interpret. Measures have been frequently introduced, revised or withdrawn with little notice.

Legal challenges to the administration's tariff authority further increased uncertainty. The result has been an extraordinary rise in measured policy uncertainty, with Economic Policy Uncertainty and Trade Policy Uncertainty reaching record highs in the first half of 2025.<sup>1</sup>

Compared with the pandemic, there was less model uncertainty, as the effects of tariffs on trade and output are relatively well understood in principle. However, parameter uncertainty was acute. The magnitude and the sectoral and regional incidence of the effects depended on factors such as the extent of exchange rate adjustment, the degree of substitution between Mexican goods and other imports in the US market, and the incidence of tariffs across exporters, importers and consumers. General equilibrium quantitative trade models have been central to the analysis. For example, these models made clear that third-country effects play a key role in understanding how the shift in US trade policy affects any given country. In the case of Mexico, the expected impact on prices and output of an increase in US tariffs on imports from Mexico varies depending on whether, for example, China is also tariffed or not, and whether other countries are tariffed at a higher or lower rate than Mexico. However, model predictions are sensitive to assumptions and estimated trade elasticities may vary significantly by product, sector and time horizon. Substitution is limited in the short run, but potentially larger over longer horizons. While these models suggest large negative consequences for Mexico and relatively limited ones for the United States, they do not provide information about the timing of effects. When mechanisms are well known but parameter values are uncertain, sensitivity analysis and observed adaptation can help anchor the assessment.

Uncertainty was also amplified by the difficulty of gauging how firms and households would adapt. A key unknown was the degree to which Mexican exporters would be able to adjust in the short run towards a greater use of the USMCA. For some firms, complying with the treaty may have simply implied bearing an additional administrative burden, while for others it would have also meant adjusting their supply chains. Gaps in our knowledge regarding the firm-level use of the USMCA, as well as about the organisation of their supply chains, made it difficult to benchmark the degree of possible adjustment.<sup>2</sup> These potential micro-level adjustments were hard to anticipate and further complicated the interpretation of aggregate trade data.

In this setting, Banco de México deemed that the communication strategy for monetary policy decisions would be more effective by taking a cautious stance for its growth and inflation outlook. Given the lack of clarity about US policy goals, advancing conclusions about the likely consequences of announced but not-yet-implemented policy changes could yield undesirable outcomes.

A particular challenge for monetary policy was that US tariffs also posed inflation risks for Mexico on both sides of the balance. On the upside, higher input costs in the

<sup>1</sup> See S Baker, N Bloom and S Davis, "Measuring economic policy uncertainty", *The Quarterly Journal of Economics*, vol 131, no 4, November 2016, pp 1593–636.

<sup>2</sup> Information gathered through Banco de México's firm survey (EMAER – its acronym in Spanish) in April 2025 indicated that nearly 22% of firms that previously did not use the USMCA for their exports to the United States, or that only used it for some exports, had begun or were intending to begin making more use of the treaty. This survey also revealed that there was a group of firms that wanted to make more use of the treaty to export to the United States but did not know how. This suggested that information frictions could play an important role in the micro-level adjustments underlying export activity.

United States and the possibility of a peso depreciation threatened to raise domestic inflation. On the downside, a contraction in US and Mexican economic activity could weaken demand and dampen price pressures. In addition, given the observed disinflation and the inflation outlook at the beginning of 2025, the Governing Board judged that a calibration of monetary policy aimed at easing the restrictive stance was consistent with convergence towards the 3% inflation target. As such, during the first half of the year, at consecutive policy meetings from February to June 2025, the policy rate was reduced by four consecutive 50 basis point cuts. After this calibration stage, and having considered the inflationary outlook, the Governing Board deemed it appropriate to continue with the easing cycle and decided on a 25 basis point reduction in each of the August and September meetings, bringing the reference rate to 7.50%. In this context, to guide expectations and clearly communicate its assessment regarding the implications of US tariff announcements, Banco de México emphasised a single baseline forecast, explaining the assumptions underpinning its projections. It also placed greater emphasis on the balance of risks for economic activity.

Beyond the near-term outlook, while the shift in US trade policy poses challenges for the global economy, it also creates opportunities for Mexico under the upcoming 2026 USMCA review. In particular, trade diversion and nearshoring could further strengthen Mexico's export position and deepen its role within North American value chains.

This trade policy episode highlights how external policy developments can influence the outlook for an open economy like Mexico. During the pandemic, the main challenge was assessing the evolution of economic activity in light of the uncertainty regarding the nature of the profound effects caused by the health shock. In contrast, the current episode involves clearer mechanisms, but the parameters determining the magnitude of effects and permanence of policy are unknown. For monetary authorities, this has meant balancing upside and downside inflation risks and adapting communication to explain how the decisions being taken are consistent with the inflation target. The broader lesson is that when uncertainty stems from certain policy measures, central banks must not add to the uncertainty.

## Conclusions

The global economic environment is undergoing profound transformations that have challenged long-held assumptions and added complexity to policy design. While the uncertainty episodes highlighted in this article have been atypically acute, it is clear that uncertainty is not an exception but a constant in monetary policymaking. Uncertainty cannot be eliminated, but central banks can rigorously assess it and communicate its implications with transparency. Indeed, our responses to uncertainty may rest on three pillars: technical rigour, institutional credibility and transparent communication. A robust and adaptive economic analysis, informed by lessons from past episodes, can help guide policy decisions. Recognising the limitations of existing models and prior assumptions is also essential, as central banks must remain vigilant and ready to adjust to a rapidly evolving and often unpredictable economic landscape. To further reduce policy uncertainty, it is important that central banks clearly explain how new information shapes their decisions.